

**BEFORE THE  
POSTAL RATE COMMISSION**

---

RECEIVED

SEP 13 1 43 PM '00

RECEIVED  
OFFICE OF THE CLERK

**Docket No. R2000-1**

---

**POSTAL RATE AND FEE CHANGES, 2000**

---

**INITIAL BRIEF OF ASSOCIATION FOR POSTAL  
COMMERCE AND MAIL ADVERTISING  
SERVICES ASSOCIATION INTERNATIONAL**

Communications regarding this document should be served on

Ian D. Volner  
N. Frank Wiggins  
Venable, Baetjer, Howard & Civiletti, LLP  
1201 New York Avenue, N.W.  
Suite 1000  
Washington, DC 20005-3917

Counsel for Association for Postal Commerce and  
Mail Advertising Services Association International

Dated: September 13, 2000

## TABLE OF CONTENTS

I.	The Commission Should Recommend Rates Reflecting Drop Shipment Discounts that Credit Mailers with One Hundred Percent of the Cost Savings of Worksharing Activities that Inhere to the Benefit of the Postal Service .....	2
II.	The Postal Service has Significantly Understated the Cost Savings Associated with Automation Rate-Eligible Standard (A) Regular Flats .....	4
III.	The Alternate Rate Proposals of Dr. Clifton and Mr. Callow Do Not Warrant Deviation from the Rates Proposed by the Postal Service .....	6
A.	The Theme of Dr. Clifton's Original Testimony Is Not Persuasive .....	6
B.	Mr. Callow's Defense of Retention of the Thirty-Three Cent First-Ounce First-Class Rate is Unpersuasive .....	8
C.	Dr. Clifton's "Revised and Updated Supplementary Testimony . . ." Has a Different Theme Than His Initial Testimony But No More Merit .....	11
D.	Conclusion .....	14
	Conclusion .....	14

**BEFORE THE**  
**POSTAL RATE COMMISSION**

---

**Docket No. R2000-1**

---

**POSTAL RATE AND FEE CHANGES, 2000**

---

**INITIAL BRIEF OF ASSOCIATION FOR POSTAL COMMERCE  
AND MAIL ADVERTISING SERVICES ASSOCIATION INTERNATIONAL**

The Association for Postal Commerce and Mail Advertising Services Association International (collectively, PostCom) submit this brief in support of the positions that it has advocated in Docket No. R2000-1.

PostCom sponsored the testimony of Sander A. Glick, PostCom et al.-T-1. Mr. Glick's testimony advocates an increase in the drop shipment discounts for Standard (A) mail, urging that a full one hundred percent of what the Postal Service measures as the cost savings associated with drop shipment should be passed through to mailers that engage in drop shipment work sharing activities. This testimony is augmented by that of Joseph E. Schick who argues that there are collateral benefits to the Postal Service from encouraging more drop shipping. Drop shipping is directly related to the presentation of mail on pallets and the Postal Service achieves economies in handling palletized, instead of sacked, mail. Larger discounts should encourage more drop shipping which will result in more palletized mail.

Mr. Glick also argues that the Postal Service has substantially understated the value of automation work sharing activities of Standard (A) mailers and, consequently, overstated the pass through value of discounts associated with those undertakings. This portion of Mr. Glick's

testimony is supported by that of Joe Lubenow. Mr. Lubenow establishes that compliance with automation eligibility requirements has a demonstrable relationship with improved address quality, a characteristic that saves the Postal Service money by diminishing UAA mail and other address flaws that make the delivery function more expensive. PostCom does not recommend an increase in any of the automation discounts, but urges that the Commission accurately reflect, as the Postal Service's presentation has not, the true value of these work sharing activities.

**I. The Commission Should Recommend Rates Reflecting Drop Shipment Discounts That Credit Mailers With One Hundred Percent of the Cost Savings Of Work Sharing Activities That Inhere to the Benefit of The Postal Service.**

Quoting from Mr. Bernstein's testimony in Docket No. R97-1, Mr. Glick shows that economic theory, and particularly the principle of Efficient Component Pricing (ECP), mandates the pass through of 100 percent of cost savings:

Under ECP, the price difference between a non-work shared mail category and its work shared component should equal the difference between the Postal Service cost of the non-work shared and work shared mail category,

PostCom et al.-T-1 at 3, Tr. 32/15717, lines 19-22 quoting USPS-T-31 in Docket No. R97-1 at 72-73. At table two of his testimony, Mr. Glick sets out the discounts that result from his proposal. The rates that result from application of these discounts are set out at Attachment A to PostCom et al.-T-1, Tr. 32/15734. The proposal is revenue neutral. The increase in destination entry discounts is offset by an increase in the rates for mail that is not destination entered. In his response to USPS/PostCom-T1-2, Mr. Glick offers the following explanation of his preference for the outcome that he recommends despite the fact that it results in significant increases in the rates for non-destination entry mail:

USPS/PostCom-T1-2. Please see Attachment A of your testimony which includes PostCom proposed rates for Standard Mail (A).

a. Please confirm that the PostCom proposed increase for non-destination entry 3/5-digit automation flats is 15.8 percent. If you cannot confirm please provide the percentage increase you are proposing for non-destination entry 3/5 digit automation flats.

\* \* \*

a. Confirmed. Note that this rate increase is only slightly higher than the increase that the Postal Service is proposing for DSCF entry 3/5-digit automation flats. To the extent that mitigating rate shock should be considered in rate design, I believe that a 15.8 percent rate increase for non-destination entry mail is an improvement over a 14.8 percent rate increase for DSCF entry mail because non-destination entry mailers have an opportunity to reduce their rate increase through increased worksharing.

Tr. 32/15740. Although Mr. Glick's proposal may be viewed by the Postal Service as hurtful to some users of the Standard (A) Regular and ECR mail services, it is based on sound economic principles and should be adopted.

Mr. Schick's testimony underscores this conclusion. He explains the business reality of the relationship between containerization and drop entry:

For drop entered mail, it is almost imperative to use pallets to the maximum extent possible. Pallets permit most efficient use of the cubic capacity of the truck thereby keeping the transportation cost – paid for by the mailer – at the lowest feasible level. . . . However, for mail that is not drop entered and for mixed loads where only a portion of the load will qualify for the discount, the decision as to the choice of container is very different: Since the mailer has already paid for Postal Service-provided transportation through the undiscounted rate, the mailer's only incentive is to find the least costly means of getting the mail on the Postal Service trucks (in a plant load operation) or to the closest postal facility.

PostCom et al. –T-2 at 3, Tr. 32/15704 line 13-05 line 1. From these observations Mr. Schick concludes that, "it is also the case that the more mail that is dropped entered, the more mail that will be based on pallets." Id. Tr. 32/15706, lines 22-23. As Mr. Schick, testifies Tr. 32/15707-8, and as we believe to be undisputed and indisputable, palletization benefits the Postal Service.

Thus, the incidental benefits to the Postal Service of palletization which is a near necessary concomitant to drop shipment argues that as much drop shipment as is economically reasonable should be encouraged by the Postal Service. That, in turn, means that all of the cost savings to the Postal Service associated with drop shipment should be recognized because that recognition will result in more drop shipment and consequently more pallets.

All told, full reflection of the Postal Services drop shipment cost savings should be mirrored in the destination entry discounts in order to encourage marginal drop shipment.

## **II. The Postal Service Has Significantly Understated the Cost Savings Associated With Automation Rate-Eligible Standard (A) Regular Flats.**

Mr. Glick develops four points in his demonstration that “incorrect and inconsistent assumptions in the Postal Service’s flats cost model, USPS-LR-I-90, understate cost savings by a significant amount:

- The flats model overstates FSM 881 accept rates for nonbarcoded flats.
- The flats cost model fails to take into account the lower wage rates that are paid to BCR/OCR clerks as compared to keyers and clerks who manually sort flats.
- The flats cost model understates the proportion of incoming secondary sorts that will be performed on flat sorting machines in the Test Year.
- The flats cost model uses inconsistent assumptions regarding FSM 1000 keying and FSM 1000 BCR productivities. This results in a data anomaly.

PostCom et al.-T-1, 7 Tr. 32/15721, lines 1-18. The arguments on which these conclusions are based are concisely presented at pages 8-15 of Mr. Glick’s testimony, Tr. 32/15722-28. At

Table 6 of his testimony, Tr. 32/15729, Mr. Glick summarizes the cost consequences of his adjustments to the Postal Service's flats cost model using a revised version of that model. MPA-LR-2, that was developed by Mr. Glick in conjunction with Mr. Stralberg. As the table shows, the Postal Service has underestimated basic automation savings by just under 1.6 cents per piece and 3/5 automation savings by slightly less than .8 cents per piece. Using the revised savings numbers results in an effective pass through of automation savings of 126 percent in the basic automation category and 204 percent in the 3/5 automation cost category. Tr. 32/15729, Table 6.

The testimony from Joe Lubenow sponsored by PostCom et al. is, in part, complimentary to that of Mr. Glick. Although the main burden of Mr. Lubenow's testimony is to criticize the Postal Service's proposal for moving away from incentives toward improvements in address quality (see, e.g., PostCom et al.-T-3 at 8-9, Tr. 29/14089-90) and to suggest rate design reforms, Mr. Lubenow affirms that certain existing requirements such as Cost Accuracy Support System (CASS) certification do help to improve address quality. Id. at 10-11, Tr. 29/14091-92. Mr. Lubenow also demonstrates that increases in address quality reduce Postal Service costs. Id. at 21-23, Tr. 29/14102-04. As Mr. Glick establishes, these benefits are not entirely reflected in the Postal Service's measurement of automation related cost savings. PostCom et al.-T-1, 17, Tr. 32/15731. Thus, although not quantifiable, the cost benefits to the Postal Service of the automation program are even greater (and the pass throughs of those costs smaller) than restated in Mr. Glick's testimony.

The automation rates proposed by the Postal Service should be recommended by the Commission.

**III. The Alternate Rate Proposals of Dr. Clifton and Mr. Callow Do Not Warrant Deviation From The Rates Proposed By The Postal Service.**

Dr. Clifton, for the American Bankers Association and the National Association of Presort Mailers, and Mr. Callow, for the Office of Consumer Advocate, offer alternate rate proposals that share a common theme. Both argue that institutional costs coverages should be shifted from First-Class mail to Standard (A) mail. None of these proposals has merit because of the rationales behind them are not sound. We examine each of the proposals in what follows.

**A. The Theme Of Dr. Clifton's Original Testimony Is Not Persuasive.**

One of the themes of Dr. Clifton's testimony is that institutional cost coverage of First-Class and Standard (A) mail have deviated impermissibly from standards articulated by the Commission in its decision in Docket No. R90-1. The following passage is illustrative:

Q Those statutory terms to which you adverted, Dr. Clifton, fair and equitable in (B) (1) and reasonably assignable (B) (3), those seem to me fairly flexible terms.

Can you tell me how in your analysis you determine how much is fair and equitable and how much is reasonably assignable? What is the standard that you apply to come to the conclusions that you do?

A The standard I apply is subjective, like the Postal Service's, and partly objective as well.

The objective part of it, I believe, is harking to what the Postal Rate Commission said was the Commission's long-term goals for cost coverages, specifically of First-Class mail and Bulk Rate Regular in R90, evaluating that Commission statement in R90 against what has happened over the past decade to the cost coverages of those two class of subclasses.

Based on those dynamic considerations, which are objective and measurable, I argue that we should harken back to the Commission's R90 goals and reduce the cost coverage of the First-Class letter mail subclass and increase – these are marginal

adjustments – increase at the margin the cost coverage for Standard A Commercial mail, to get back closer to those goals.

Q Do you think that the Commission has changed the goals from what they were in R90?

A That is a good question, Mr. Wiggins

One answer is I don't know but based on my examination of the O&RDs, I do not find in the record of O&RDs in MC95, R97-1, R94 or R97 anywhere close to as an explicit statement as you find in R90 as to what those goals are.

I therefore have to conclude that, no, the Commission has not changed its long-term goals relative to those pretty explicitly and well laid out in R90.

Tr. 26/12652, line 9-53, line 17. At one point Dr. Clifton expressed the expert economist opinion that the some of the rates at issue are unlawful, violative 39 U.S.C § 3622(b)(1) & (3).

Response to DNA/ABA&NAPM-T1-3, Tr. 26/12567. Asked directly about this position, Dr.

Clifton declined to answer directly, but seemed to moderate his response somewhat:

Q Is it your assertion that the coverages recommended by this Commission in R97, for example, were violative of those two provisions of the statute?

A In some interpretations of the Commission's decision in R97-1 they made a very, very, very tiny effort to move back to what I would consider to be an equitable, a more equitable set of cost coverage ratios.

I don't think it was enough and I think this rate case presents us with an opportunity, indeed a necessity in light of that electronic diversion study for First-Class mail, to move back to relative cost coverages such as we did see in the '90s, earlier in the '90s.

My proposals do not talk about changing cost coverages outside of any range that existed within the 1990s. I would just like to see them restored to something that might have existed earlier in the decade.

Tr. 26/12651 line 18-52, line 9.

It is both bad law and bad policy to assert that the Commission has bound itself to pronouncements in R90-1 and that it is under some legal compunction to recur to those standards. The Commission has, as a matter of law, much broader discretion than that. See, e.g., National Association of Greeting Card Publishing v. U.S. Postal Service, 462 U.S. 810, 822-23 (“There is no suggestion in the legislative history that Congress viewed the exercise of discretion as an evil in itself. Congress simply wished to substitute the educated and politically insulated discretion of experts for its own.”) Dr. Clifton should not be permitted to impose on the Commission restraints rejected by the Congress.

B. Mr. Callow’s Defense Of Retention Of The Thirty-Three Cent First Ounce First-Class Rate Is Unpersuasive.

Mr. Callow makes an interesting variation on Dr. Clifton’s institutional cost presentation.<sup>1</sup> Unlike Dr. Clifton, Mr. Callow does not accuse the Commission of impermissibly veering from established precepts for assigning institutional costs, but urges that “. . . the additional revenue contributed by First-Class Letter Mail to the Postal Service’s institutional cost has exceeded the revenue contribution intended by the Commission. “OCA-T-6 at 21, Tr. 22/10119. Mr. Callow proposes to rectify the problem that he perceives” . . . by maintaining a

---

<sup>1</sup> Except as addressed in this footnote, this brief will not discuss Part II of Mr. Callow’s proposal, the rate stability proposal, and will not discuss Part III of his testimony at all. Mr. Callow conceded that the Commission should not endorse the rate stability proposal in this case if it does accept his suggestion that there be no increase recommended. First-Class first ounce stamp Tr. 22/10246, lines 6-15. Conversely, if the rate stability proposal were endorsed, a First-Class first ounce stamp rate of at least 34 cents would be required. Id. lines 16-21. Although he recommends a 34 cent First-Class first ounce stamp in conjunction with the proposal, Mr. Callow conceded that he had not performed the cost analysis necessary to have confidence that that rate would cover costs over a four year period. Tr. 22/10248, lines 4-17. And Mr. Callow conceded that the two year rate cycle that he employed “for illustrative purposes” cannot be imposed on the Board of Governors, 22 Tr. 10250, lines 5-17. He also conceded that the mechanics of rate making would have to be altered in what sounds like a fairly substantial fashion to permit his proposal to work. Tr. 22/10254, line 2-10. And Mr. Callow conceded that if the rate case interval is greater than two years, the prediction concerning coverage would get less certain, Tr. 22/10257, line 18-58.

single piece First-Class rate at 33 cents.” Id. at 24, Tr. 22/10122, line 5. Like Dr. Clifton. Mr. Callow believes that First-Class mail has contributed more than it should have to defray institutional costs over the last ten years or so.

Q So, help me out a little bit conceptually here, Mr. Callow. I have got a real number in Row 8, and I am comparing that with a number that is calculated by using the average of rates recommended by the commission over a 10 year period of time, correct?

A Correct.

Q Why is that a thing that I want to be doing? Why does that make sense?

A Because the Commission has made a number of statements about the recommended cost coverage mark-up index that the – it is a goal or preference that the mark-up for First-Class and Standard A move toward equalization at the system-wide average. And I interpreted that, took the average to be reasonably near the system-wide average.

Q Well, but this is the average – this isn’t system-wide average, you don’t contend that this is system-wide average, do you?

A No.

Q This is –

A First Class

Q First Class.

A. Right

Q The average of the mark-ups that the Commission has recommended in each of the last four cases, correct?

A. Correct.

Tr. 22/10260, line 14-61, line 14.

Even when Mr. Callow avoids the vice of using an average over four rate cases in which the cost coverage of First-Class Mail has increased<sup>2</sup> he demonstrates that First-Class contribution has generally exceeded the level recommended by the Commission. See Response to DMA/OCA-T6-2 Tr. 22/10174-76. There is only one conceivable explanation for this phenomenon. As Mr. Callow's answers to interrogatories graphically depict, not all First-Class mail makes the same contribution to institutional cost, there are differences in the implicit cost coverage of single piece and presorted First-Class letters. See Responses to MMA/OCA-T6-1-5, Tr. 22/10195-99. Mr. Callow conceded that the differences in implicit cost coverages among different varieties of First-Class mail might explain the "excessive" institutional cost coverage about which he testified. Tr. 22/10279-80. That explanation is, so far as our analysis permits us to conclude, not just possible but the only conceivable explanation for the phenomenon. If, but only if, the mix of First-Class mail contains a greater portion of the "more profitable" – higher implicit cost coverage – First-Class mail in the mail stream than contemplated by the Commission in the course of setting institutional cost coverages, the contribution of First-Class mail will be above the averaged cost coverage set by the Commission.

One must wonder what the vice is in this. Not having examined implicit cost coverages, Mr. Callow could not supply an answer to that question. Tr. 22/10280 lines 5-14. The short answer is that there is none. There are implicit cost coverages for different rate categories in every subclass of mail. When projections of the mix of mail go slightly awry, so to does the subclass-wide cost coverage. That is not an indictment, or at least one that ought to be of concern, of the way in which the Commission traditionally has made and should continue to make rates. Mr. Callow's perception that First-Class mail is contributing too much to

---

<sup>2</sup> Almost certainly, this development is owed at least in part to the phenomenon to which Mr. Clifton testified, the proportional increase of institutional costs owing to work sharing. Tr. 26/12646.

institutional costs is only another way of saying that the rate structures put in place by the Commission have induced larger volumes of higher implicit cost coverage First-Class mail. It is probably right that a careful effort should be made to predict more accurately the volumes of various rate categories within subclasses. But the fact that such projections have not been exact do not serve as a basis for supplanting the Commission's usual careful analysis of the statutory criteria for institutional cost coverage with so dull an instrument as a rate freeze.

C. Dr. Clifton's "Revised And Updated Supplementary Testimony . . ." Has A Different Theme Than His Initial Testimony But No More Merit.

A main theme of Dr. Clifton's supplemental testimony is that the "break through productivity" cost savings reflected in the various Order 1294 filings revisions are unbalanced; they benefit too little the categories of mail primarily used by his clients. He has a direct resolution for this; he would have the Rate Commission order the Postal Service to accomplish comparable savings in cost pools that effect the First-Class work sharing mail services employed by Dr. Clifton's clients:

Q Dr. Clifton, at page 8 of your testimony, there appears a section heading that reads as follows, "Increased cost reduction efforts from 'breakthrough productivity' in the 1294 revisions are laudable, but the allocation of them in the roll-forward exhibits a clear-cut bias against First-Class workshared mail." And that is sort of central theme through at least this portion of your testimony, is not?

A I have a difference page 8 apparently, Mr. Wiggins, but I think that is the gist of it.

Q It has most of those same words in it, does it not?

A Yes.

Q Okay. Good. So that is an articulation of what you perceive to be a problem. Now, the question is, how do you

perfect the cure? What do you propose to do to resolve this problem that you have isolated for us?

A I don't propose to reduce any of the breakthrough productivity initiatives for Standard A mail or First-Class single piece mail. I simply propose that the Postal Service make a balanced effort to include First-Class workshared mail and its productivity enhancements, what I call balanced cost reductions.

Tr. 45/20155-56. The changes that Dr. Clifton proposes are clearly identified at Table A2.1 of his testimony, Tr. 45/20151. He explained, both in his testimony, Tr. 45/20096, lines 11-15, Tr. 45/20098, lines 1-9, and on the stand how he had selected the cost pools that he would Rate Commission force the Postal Service to reduce:

Q Can I ask you what, sort of at a higher level of generality, what the general selection precept was, what was the theory?

A Sure. Certainly. I think it is clearly stated in the testimony, Mr. Wiggins. But the selection criterion was, as I observed the changes in cost pools between the Postal Service's original case and the 1294 revisions, the cost reductions for Standard A that were made by cost pool were made on the basis of bringing down several of those cost pools to their First-Class automation mail counterparts, but the Postal Service, in its cost reduction efforts, did not appear to do the reverse, to bring the unit costs for First-Class workshared mail down to the Standard A counterparts, where they were higher in the initial case.

It appears to me that that was the Postal Service's selection rule, because it is a very clear pattern in here, and we simply proposed to balance that out by doing for First-Class what was done – workshared what was done for Standard A workshared.

Q So that when I look at something like LD15, which is the first example, and you are proposing that that number be reduced by .03 cents, that proposal doesn't purport to be a reflection of a real historical economy, does it, Dr. Clifton?

A No, none of these cost reduction is or breakthrough productivity initiatives are reflections of history. They were described as managerial goals in the Fiscal 2001 Operating Budget.

Q And you are proposed some additional managerial goals for the Postal Service here, is that correct?

A Yes.

Q You are saying, Postal Service, go out and achieve these economies?

A Yes.

Tr. 45/20158, line 6-59, line 14.

There is no vice in Dr. Clifton proposing managerial goals to the Postal Service. There is a profound legal impediment to this Commission seeking to impose such goals:

Congress did not intend that the Postal Rate Commission regulate the Postal Service; one partner does not regulate another, and authority to assist in ratemaking and classification does not include authority to interfere in management. It follows that a management decision by the Postal Service may not be overruled or modified by the Rate Commission.

Newsweek, Inc. v U.S. Postal Service, 663 F.2d 1186, 1203(2d Cir. 1981) quoting Governors of the United States Postal Service v. United States Postal Rate Commission, 654 F.2d 108, 114-15 (D.C.Cir. 1981). Even were Dr. Clifton right, as there is no reason to believe that he is, that the Postal Service has been unfair in selecting its breakthrough productivity targets, that conclusion would not permit Postal Rate Commission interference with managerial prerogatives:

Once the Commission puts forward a proposal that it deems necessary for reasons of fairness and equity, however, it has the additional duty to consider whether this proposal interferes with the Postal Service's management authority.

Mail Order Association of America v. U.S. Postal Service, 2 F.3d 408, 424 (D.C. Cir. 1993).

What Dr. Clifton asks this Commission does not have the power to grant.

D. Conclusion

Neither of Dr. Clifton's proposals concerning First-Class rates should be endorsed by the Commission. Neither Mr. Callow's rate stability proposal nor his suggestion of First-Class first ounce rate freeze in this case should be recommended.

**CONCLUSION**

Except for adopting the Postal Service's Standard (A) destination entry rates to reflect fully the economies enjoyed by the Postal Service as a result of this work sharing activity, this brief proposes no alteration in the rates presented by the Postal Service for Standard (A) mail.

Respectfully submitted,



Ian D. Volner  
N. Frank Wiggins  
Venable, Baetjer, Howard & Civiletti, LLP  
1201 New York Avenue, N.W.  
Suite 1000  
Washington, DC 20005-3917

Counsel for Association for Postal Commerce and  
Mail Advertising Services Association International

## **CERTIFICATION**

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with Section 12 of the rules of practice.

  
- Ian Volner